MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

February 24, 1995

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: EX-PARTE, CC Docket 94-1

Dear Mr. Caton: DOCKET FILE COPY ORIGINAL

In accordance with the Commission's Rules governing EX-PARTE communications, be advised that today the attached written EX-PARTE from MCI's Chairman, Bert Roberts, was sent to Chairman Hundt and Commissioners Barrett, Chong, Ness and Quello.

Please place a copy of this notice and the attached in the record of the above captioned proceeding.

Sincerely,

Donald F. Evans

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MCI Communications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
202 887 2166

Bert C. Roberts, Jr.
Chairman and
Chief Executive Officer

February 24, 1995

RE: Ex Parte letter in CC Docket No. 94-1

Dear Chairman Hundt and Commissioners:

MCI has long been skeptical of the benefits that "incentive regulation" plans provide to ratepayers. Our experience at the federal and state levels has been that the monopoly local exchange carriers (LECs) make promises to regulators about infrastructure investment in exchange for generous "incentive" plans, and then fail to deliver.

The existing federal price cap plan is a good example. When the Commission was considering the initial price cap plan, the LECs argued to the Commission that cutting their ability to generate earnings through a lower rate of return and a higher productivity offset would interfere with desirable infrastructure investments. The Commission explicitly adjusted the rate of return upward to provide an "infrastructure fund." In addition, the Commission chose what it acknowledged was a conservative productivity offset to ensure that no LEC which was required to comply with price cap rules would find itself unable to succeed under the plan.

The fruit of those decisions has been excessively high interstate earnings by the price cap LECs -- 13.7% as of the third quarter of 1994, with returns on equity as high as 18-19% in recent years. Cash flow is also high -- higher than any other segment of the U.S. economy. The LECs' excessive access charges are the source of those dollars. Access charges are tariffed at a rate several times their actual cost, creating an enormous fund that can be used to reward shareholders and finance off-shore adventures.

Contrary to LEC promises about infrastructure investment, these dollars are not being used to pay for the development of the information superhighway, or even to improve basic telephony transmission.

If the Commission is to break the link between costs and prices and thereby give the LECs incentives to become more productive and efficient, it cannot simultaneously employ price cap regulation as a cash machine. Experience has shown that regulators have little practical ability to control how the LECs dispense their wealth. Moreover, if the purpose of price caps is to require the LECs to manage their costs and investments by creating price constraints akin to what would exist in a competitive market, then price cap parameters should be selected based on their ability to produce prices that would exist in a market subject to effective competition. Misplaced desires to use incentive regulation to drive an infrastructure spending spree are fundamentally at odds with price cap regulation.

In considering adjustments to the LEC price cap plan, MCI would like you to consider the following.

- Price cap regulation should drive rates down toward their economic cost. In the first four years of price cap regulation, access price decreases have slowed considerably, leaving access charges at rates many times their economic cost.

- Without a regulatory mechanism to drive rates to cost, ratepayers continue to pay inflated charges with ripple effects on the entire U.S. economy.

- Price cap regulation should place the onus on the LECs to become more efficient and productive, requiring the LECs to manage their investment and expenses as the competitive interexchange industry must.

- Price cap regulation should be administratively simple. Exogenous cost requirements have been exceedingly burdensome, consuming untold hours of industry and regulatory resources with no resolution of these issues to date.

- The benefits of price cap regulation cannot continue to be allocated overwhelmingly to the price cap regulated LECs.

Significant changes must be made in price cap regulation to ensure that ratepayers benefit from incentive regulation as much as the LECs do. In its comments, MCI has requested that the Commission change the carrier common line formula to a "per line" approach, increase the productivity offset to 5.9%, streamline exogenous cost treatment to include only those events that create a change in jurisdictional costs, and reinitialize the price cap index.

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A productivity offset of 5.9% would allow the LECs to achieve a reasonable return, and would challenge them to creatively manage their costs to drive out inefficiencies. Infrastructure investment would not be jeopardized -- it would be enhanced by the discipline of a price cap mechanism that more accurately simulated a competitive marketplace.

MCI also believes the Commission should reinitialize price cap indexes to capture for ratepayers a more equitable share of incentive regulation benefits than was generated by the initial price cap mechanism. A one-time adjustment to price cap indexes is also necessary to reflect that, throughout the initial price cap period, LECs faced a substantially-reduced cost of capital.

MCI urges the Commission to carefully consider the future of price cap regulation. Now is the time to transform the plan from an anemic incentive into a mechanism that drives productivity and efficiency gains, and that moves access rates towards costs.

Sincerely,

Bert C Roberts Jr

Bert C. Roberts, Jr.